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FISCAL IMPACT STATEMENT

LS 6029

BILL NUMBER: SB 23

NOTE PREPARED: Feb 19, 2004

BILL AMENDED: Feb 19, 2004

SUBJECT: Inheritance Tax Class A Transferees.

FIRST AUTHOR: Sen. Zakas

FIRST SPONSOR: Rep. Frenz

BILL STATUS: CR Adopted - 2nd House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) The bill provides that a spouse, widow, widower of a child, or stepchild of the transferor is a Class A transferee, rather than a Class B transferee, for purposes of the inheritance tax.

Effective Date: July 1, 2004.

Summary of Net State Impact: Under the bill, the state will experience a decrease in Inheritance Tax revenue beginning in FY 2006. The increase in Estate Tax revenue in FY 2006 due to the reduction in Inheritance Tax is expected to be negligible. In addition, the bill is expected to result in a small increase in state General Fund expenditures on county Inheritance Tax replacement. The net state impact of making a spouse, widow, widower of a child a Class A transferee is summarized in the table below. Information on the number of stepchildren who are transferees is not available, so the fiscal impact of making them Class A transferors cannot be estimated.

Fiscal Year	Inheritance Tax Revenues	Estate Tax Revenues	State Expenditure for County Replacement	Net Increase (Decrease)
2006	(\$1.07 M)	\$8,500	\$16,000	(\$1.08 M)
2007 and after	(1.07 M)	0.0	16,000	(1.09 M)

Explanation of State Expenditures: The bill would increase expenditures from the state General Fund for county Inheritance Tax replacement by approximately \$16,000 per year. Necessary replacement funding

could vary from this amount depending on whether, and by how much, each county's base revenue exceeds the amount guaranteed under the current statute. Including stepchildren as Class A transferees will increase this county replacement expenditures by an indeterminable amount. (See *Explanation of Local Revenues* for explanation of county revenue loss and replacement procedure.)

Explanation of State Revenues: Including a spouse, widow, widower of a child of a transferor as Class A transferee is estimated to reduce Inheritance Tax revenue by \$1.07 M annually beginning in FY 2006. Including stepchildren as Class A transferees will decrease Inheritance Tax revenues by an additional indeterminable amount. The reduction in Inheritance Tax liabilities is estimated to increase Indiana Estate Tax revenue by only about \$8,500 in FY 2006. Estate Tax revenue is expected to decline to zero beginning in FY 2007 due to the phaseout of the state death tax credit under the federal Estate Tax. Thus the estimated net revenue loss is approximately \$1.06 M in FY 2006 and \$1.07 M in FY 2007 and years after. Including stepchildren as Class A transferees will cause an additional loss of revenue.

Background on Inheritance Tax: The bill increases the Inheritance Tax exemption for transfers to a spouse, widow, or widower of a child, or stepchild of a transferor from \$500 to \$100,000. (The first three categories of individuals are currently Class B transferees and are entitled to a \$500 exemption. Stepchildren are currently Class C transferees and are entitled to a \$100 exemption. The bill would change their status to Class A transferees, entitled to a \$100,000 exemption.) The change would be with respect to transfers made by persons who die on or after July 1, 2004. Since the Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount), the full impact of the bill would not be experienced until FY 2006. The estimated impact of this change is based on the Office of Fiscal and Management Analysis (OFMA) Inheritance Tax database and the Revenue Technical Committee's FY 2004 forecast (January 12, 2004) for the Inheritance Tax totaling \$120 M. The revenue forecast is a combined amount including both Inheritance Tax and Estate Tax revenue.

Approximately \$101.5 M of the FY 2004 forecast amount is attributable to the Inheritance Tax. The Inheritance Tax database is comprised of 133,856 records of transferees receiving assets from a decedent who died between July 1, 1997, and March 30, 2003. Of the total tax liability for the sample, approximately 1.2% is attributable to the group identified as being a spouse, widow, or widower of a child of the transferor. This amounts to about \$1.2 M of Inheritance Tax liability based on the revenue forecast. The increase in the exemption for this group reduced its tax liability by about 88%. Thus, the annual decrease in revenue is estimated to total about \$1.07 M. This estimate assumes no change in Inheritance Tax revenues through FY 2007. No information is available on the number of step children that are transferees, so the amount of Inheritance Tax attributable to stepchildren is not included in these estimates..

Background on Estate Tax: Although the bill does not make changes to the Indiana Estate Tax, the reduction in Inheritance Tax liabilities for Class A transferees would affect Estate Tax revenues. However, this impact is expected to be negligible. Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the state death tax credit for federal Estate Tax purposes exceeds the total Inheritance Tax paid by transferees of the estate. Under the bill the Indiana Estate Tax would still be limited to estates paying federal Estate Tax, but for some estates a decrease in the Inheritance Tax liability paid by transferees of the estate results in a compensating increase in the Indiana Estate Tax liability. The federal Estate Tax is set to expire in 2005, as will the Indiana Estate Tax since it is linked to the federal tax. Therefore, the bill will affect Indiana Estate Tax revenues only for FY 2006.

The estimated impact of the bill on Estate Tax revenues is based on OFMA's Estate Tax database and the Revenue Technical Committee's FY 2004 forecast (January 12, 2004) of 18.5 M. The Estate Tax database consists of 559 estates of decedents who died between July 1, 1997, and June 30, 2000, and that paid Indiana

Estate Tax. The Inheritance Tax changes are estimated to increase Estate Tax revenue by approximately \$8,500 in FY 2006.

Explanation of Local Expenditures:

Explanation of Local Revenues: The bill would increase the Inheritance Tax exemption for transfers to a spouse, widow, or widower of a child of a transferor from \$500 to \$100,000 and the exemption for a stepchild of a transferor from \$100 to \$100,000 by making these individuals Class A transferees. The revenue impact of this change coupled with county Inheritance Tax replacement could result in an annual net revenue loss to counties of as much as \$76,000 (for transfers involving a spouse, widow, or widower of a child) beginning in FY 2006. The net impact is summarized in the table below. Including stepchildren as Class A transferees could further decrease county revenues. Information on the number of stepchildren who would benefit from this change is not available, so the local revenue impact cannot be estimated.

	Annual Impact Beginning in FY 2006
County Share of Inheritance Tax Revenues (Decrease)	(\$92,000)
State Expenditures for County Replacement	16,000
Net Increase (Decrease)	(76,000)

Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. About 99.3% of Inheritance Tax revenue is attributable to the resident Inheritance Tax. Based on the FY 2004 forecast of state Inheritance Tax revenue totaling \$101.5 M, annual county Inheritance Tax revenue will be approximately \$8.8 M beginning in FY 2004. Counties are guaranteed a statutorily determined amount as determined by the replacement provision established by P.L. 254-1997. The replacement provision was established to replace county Inheritance Tax revenue lost when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that each county receives Inheritance Tax revenue equal to the five-year annual average amount of Inheritance Tax received by that county from FY 1991 to FY 1997 excluding the highest and lowest years. The Inheritance Tax replacement that the state guarantees counties totals \$7.4 M per year.

Currently, most counties retain more in Inheritance Tax revenues than is guaranteed under the replacement procedure and do not receive the guaranteed replacement payment from the state. From FY 2000 to FY 2003, counties exceeded their guarantee amounts by an average of \$4.7 M annually with shortages subject to replacement totaling approximately \$204,886 per year. From the FY 2004 forecast, Inheritance Tax revenues accruing to the counties are expected to total approximately \$8.8 M per year. The change of a spouse, widow, or widower of a child of the transferor from Class B to Class A status would decrease county Inheritance Tax revenues by approximately \$92,000. The guaranteed state expenditures for county replacement would offset \$16,000 of the revenue decrease, and \$76,000 would not be replaced. Including stepchildren as Class A transferees could further decrease county revenues by an indeterminable amount.

A table showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: *State Revenue Forecast*, January 12, 2004. OFMA Inheritance and Estate Tax databases.

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